

ORIGINAL

OPEN MEETING



0000061954

MEMORANDUM

Arizona Corporation Commission

DOCKETED

OCT -4 2006

TO: THE COMMISSION

2006 OCT -4 A 11: 26

FROM: Utilities Division

AZ CORP COMMISSION
DOCUMENT CONTROL

DATE: October 4, 2006

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RE: IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, NOTICE OF STEP-ONE ACRM FILING FOR ITS SUN CITY WEST WATER DISTRICT (DOCKET NOS. W-01303A-05-0280, WS-01303A-02-0867; WS-01303A-02-0869; AND WS-01303A-02-0870)

Introduction

On August 30, 2006, Arizona-American Water Company, Inc. ("Arizona-American" or "Company") filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to implement Step-One of the Arsenic Cost Recovery Mechanism ("ACRM") authorized under Decision No. 68310¹ for its Sun City West Water District.

Arizona-American requests a Step-One ACRM surcharge of \$3.75 on the monthly customer charge and \$0.4654 per 1,000 gallons on the commodity rate. Under the Company's proposal, the average residential customer bill would increase by approximately \$8.41 (or 49.44 percent) from \$17.01 to \$25.42.

Staff recommends a Step-One ACRM surcharge of \$3.70 on the monthly customer charge and \$0.4601 per 1,000 gallons on the commodity rate. Under Staff's rate design, the average residential customer bill would increase by approximately \$8.31 (or 48.85 percent) from \$17.01 to \$25.32.

Background

The United States Environmental Protection Agency reduced the drinking water standard for arsenic from 50 parts per billion ("ppb") to 10 ppb effective January 23, 2006.

On November 22 and December 13, 2002, the Company filed applications with the Arizona Corporation Commission ("Commission") for fair value determinations of its utility plant and for permanent rate increases for five of its districts (Sun City West Water and Wastewater, Sun City Water and Wastewater, Havasu and Mohave Water, Agua Fria Water and Wastewater, and Tubac Water). On June 30, 2004, the Commission issued Decision No. 67093 establishing permanent rates for these five districts.

¹ Dated November 14, 2005

On February 15, 2005, the Commission issued Decision No. 67593 granting the Company's request to reopen the record in Decision No. 67093 for the limited purpose of serving as evidentiary basis for future ACRM filings for the affected Arizona-American water districts.

By Procedural Order issued March 29, 2005, Arizona-American was directed to file a new application indicating the relief sought regarding the ACRM, and to consolidate the new application with those existing dockets from Decision No. 67093 that would be affected by the specific relief request in its filing.

On April 15, 2005, the Company filed an application (Docket No.W-01303A-05-0280) for authority to implement ACRMs for its Agua Fria Water, Sun City West Water, Havasu Water, and Tubac Water Districts. On May 4, 2005, the Company filed a Motion to Delete the Tubac Water District from its application. By Procedural Order issued May 6, 2005, the Company's request to delete the Tubac Water District from its application was approved.

On November 14, 2005, the Commission issued Decision No. 68310 granting Arizona-American Water Company's application for authority to implement an Arsenic Cost Recovery Mechanism and a Havasu District Arsenic Impact Fee Tariff subject to the terms and conditions contained in that Decision.

On April 21, 2006, Arizona-American Water Company, Inc. filed an application with the Commission requesting authorization to implement Step-One of the ACRM for its Agua Fria water district. On June 29, 2006, in Decision No. 68825, the Commission authorized Arizona-American's request to implement Step-One of the ACRM for its Agua Fria Water District.

On October 2, 2006, the Residential Utility Consumer Office ("RUCO") filed its report on its audit of the ACRM for this instant case.

Authorization for an Arsenic Cost Recovery Mechanism (Decision No. 68310)

Decision No. 68310 conditioned approval of an ACRM surcharge on the following criteria:

1. Arizona-American shall comply with all requirements discussed in this Order as a condition of approval of the Arsenic Cost Recovery Mechanism.
2. Arizona-American Water Company shall file a plan with Docket Control as a compliance item in this docket by December 31, 2005, that describes how the Company expects to attain and maintain a capital structure (equity, long-term debt, and short-term debt) with equity representing between 40 and 60 percent of total capital.
3. Arizona-American Water Company shall file, by April 1st of each year subsequent to any year in which it collects surcharges under an ACRM, a report with Docket

Control as a compliance item in this docket showing the Company's ending capital structure by month for the prior year.

4. Arizona-American Water Company shall modify the rate base calculation for the Havasu Water District to explicitly show a deduction for Arsenic Impact Fee collections.
5. That as part of the Earnings Test schedule filed in support of the ACRM, Arizona-American Water Company shall incorporate adjustments conforming to Decision No. 67093.
6. Arizona-American Water Company shall file the schedules discussed in its application, as modified by Staff's recommendations herein. Microsoft Excel or compatible electronic versions of the filings and all work papers should be filed concurrently with all ACRM filings.
7. Arizona-American Water Company shall file permanent rate applications for its Sun City West, Agua Fria, and Havasu districts by no later than April 30, 2008, based on a 2007 test year.
8. For the Havasu District, Arizona-American Water Company shall file with Docket Control as a compliance item in this docket by January 31st of each year, an annual calendar year status report, until the AIF Tariff is no longer in effect. The status report shall contain a list of all customers that have paid the AIF, the amount each customer has paid, the amount of money spent from the AIF, and a list of all facilities that have been installed with funds from the AIF Tariff.
9. Arizona-American Water Company shall file the schedules and information described above, as well as any additional relevant data requested by Staff, as part of any request for an Arsenic Cost Recovery Mechanism step increase.
10. Directed Staff and the Company to open a new proceeding² to examine other forms of mitigation of the ACRM for the Havasu system, including the use of hook-up fees for adjacent systems due to the Commission's concern about the impact on the bills of customers served by the Havasu system from the implementation of the ACRM.

Filing Requirements Compliance (Decision No. 68310)

Staff performed an examination of the Sun City West Water District ACRM filing and concluded that it conforms to the requirements specified in Decision No. 68310.

² Docket No W-01303A-05-0890 is addressing this issue. A hearing was held on May 8, 2006 and the matter is under consideration by the Hearing Division.

Arizona-American's ARCM filing includes the following schedules that conform to the methodologies required by Decision No. 66400 and adopted by Decision No. 68310.

1. Balance Sheet – dated June 30, 2006.
2. Income Statement – period ending June 30, 2006.
3. Income Statement Adjustments (Earnings Test) – to conform to Decision No. 67093.
4. Rate Review – a rate review filing for the Sun City West Water District.
5. Arsenic Revenue Requirement – an arsenic revenue requirement calculation for Step-One.
6. Surcharge Calculation – a detailed surcharge calculation.
7. Rate Base – a schedule showing the elements and the calculation of the rate base.
8. CWIP Ledger – a ledger showing the construction work in progress account.
9. 4-Factor Allocation for June 30, 2006 – a schedule showing the allocation for all of the Arizona-American Water Company Districts.
10. Typical Bill Analysis – ACRM Step-1 – A typical bill analysis showing the effects on residential customers at various consumption levels including the Average Residential use of 10,020 gallons.

The ACRM schedules provide a basis for the calculation of the surcharge based on financial records and an Earnings Test Schedule which limits the ACRM surcharge when the resulting calculation would result in a rate of return exceeding that authorized in Decision No. 67093.

Arizona-American filed a plan with Docket Control on November 30, 2005, that describes how it expects to attain and maintain a capital structure (equity, long-term debt, and short-term debt) with equity representing between 40 and 60 percent of total capital.

Arizona-American docketed its annual AIF compliance report on February 2, 2006, for the Havasu District containing a list of all customers that have paid the AIF, the amount each customer has paid, the amount of money spent from the AIF, and a list of all facilities that have been installed with funds from the AIF Tariff.

Staff's Adjustments to Company Schedules

Staff reviewed the Company's invoices and found that some invoices should be removed because they were not incurred for arsenic treatment plant as discussed in detail in the attached Engineering Memorandum. A Company provided work paper³ indicated that the total cost of the project (i.e., plant and allocated labor costs) was \$134,568. Staff removed the plant and related allocation of labor costs. The adjustment reduced Arsenic Treatment Plant by \$134,568 from \$13,797,494 to \$13,662,926 as shown on CSB-1.

The adjustment to Arsenic Treatment Plant also reduced depreciation expense by \$6,756 from \$373,138 to \$366,382 also shown on CSB-1. Staff's depreciation adjustment was calculated based on the Commission authorized depreciation rates by account.

The adjustments to plant and depreciation expense reduced the Step-One surcharge revenue requirement by \$24,575 from \$1,833,754 to \$1,809,180 as shown on CSB-2 and CSB-3.

Staff's adjusted Step-One ACRM surcharge revenue requirement reduces the Company proposed monthly minimum surcharge per equivalent billing unit (5/8-inch meter) from \$3.75 to \$3.70 and the commodity surcharge rate from \$0.4654 to \$0.4592 per 1,000 gallons.

The Staff recommended Step-One ACRM surcharge rates would increase the average monthly residential customer bill by \$8.31 (or 48.85 percent) from \$17.01 to \$25.32 as shown on CSB-4.

RUCO's Analysis and Adjustments to Company's Schedules

RUCO removed costs related to refurbishing a well that it determined was not related to arsenic treatment plant. RUCO's report states that "The Company agrees that the Task order, related AFUDC, and overhead in the amount of \$101,044 should be removed from the ACRM filing." The adjustment reduced Arsenic Treatment Plant by \$101,044 from \$13,797,494 to \$13,696,450.

The adjustment to Arsenic Treatment Plant also reduced depreciation expense by \$3,334 from \$373,138 to \$369,804. RUCO's depreciation adjustment was calculated using a composite depreciation rate of 2.70 percent.

The adjustments to plant and depreciation expense reduced the Step-One ACRM surcharge revenue requirement by \$14,030 from \$1,833,754 to \$1,819,724.

RUCO recommends a \$3.72 surcharge for the monthly minimum and a \$0.4620 per 1,000 gallons on the commodity rate.

³ Excel file name: CWIP Lgr & Depreciation .xls; Worksheet name: ACRM Depreciation Rate

Discussion of Well Costs

Staff and RUCO both removed costs related to the well. Staff determined that the well cost is related to the Company's source of water production and not part of the arsenic treatment facility. A Company provided work paper indicated that the total cost of the project was \$134,568 (i.e., \$101,044 in plant and \$33,523 in allocated labor costs). Staff removed the total cost of the well project as calculated and reported by the Company, and RUCO removed the plant cost absent the related allocation of labor. Therefore, Staff recommends adoption of its adjustment because it reflects removal of all the non-arsenic related costs.

Staff and RUCO removed depreciation expense related to the disallowed well of \$6,756 and \$3,334, respectively. Staff recommends its depreciation expense over RUCO's because it recognizes the Commission authorized depreciation rates by account and Staff's recommended arsenic treatment plant balances.

Conclusion and Recommendations

Staff concludes that the Company's Step-One ACRM filing for its Sun City West Water District, as adjusted, is complete and in accordance with Decision No. 68310.

Staff recommends that the Company file with the Commission an arsenic removal surcharge tariff consistent with ACRM Schedule CSB-4.

Staff recommends that Arizona-American Sun City West Water District notify its customers of the arsenic cost recovery surcharge tariff approved herein within 30 days of the effective date of this Decision.

Staff recommends that in the event that Arizona-American fails to file a permanent rate application for its Sun City West Water system by April 30, 2008, based on a 2007 test year as required by Decision No 66310, the Arsenic Cost Recovery Mechanism surcharge then in place shall be automatically discontinued.



Ernest G. Johnson
Director
Utilities Division

EGJ:CSB:lhv\DR

Originator: Crystal S. Brown

RATE DESIGN

	Company Present Rates Without Surcharge	Company Proposed Surcharge	Staff Recommended Surcharge
Monthly Customer Charge			
5/8" Meter	\$ 5.87	\$ 3.75	\$ 3.70
Commodity			
Commodity Rate 0 to 4,000 gallons	0.850	0.4654	0.4592
Commodity Rate 4,001 to 15,000 gallons	1.285	0.4654	0.4592
Commodity Rate 15,001 gallons and over	1.551	0.4654	0.4592
Average Customer Water Usage (gallons)	10,023	10,023	10,023
Typical Residential Bill			
Under Present Rates Without Surcharge	\$ 17.01		
Under Present Rates With Company Proposed Surcharge		\$ 25.42	
Under Present Rates With Staff Recommended Surcharge			\$ 25.31

CURRENT RATES INCLUDING SURCHARGE - Per Company

	Company Present Rates Without Surcharge	Company Proposed Surcharge	Company Total
Monthly Customer Charge			
5/8" Meter	\$ 5.87	\$ 3.75	\$ 9.62
Commodity			
Commodity Rate 0 to 4,000 gallons	0.850	0.4654	\$ 1.32
Commodity Rate 4,001 to 15,000 gallons	1.285	0.4654	\$ 1.75
Commodity Rate 15,001 gallons and over	1.551	0.4654	\$ 2.02

CURRENT RATES INCLUDING SURCHARGE - Per Staff

	Company Present Rates Without Surcharge	Staff Recommended Surcharge	Staff Total
Monthly Customer Charge			
5/8" Meter	\$ 5.87	\$ 3.70	\$ 9.57
Commodity			
Commodity Rate 0 to 4,000 gallons	0.850	0.4592	\$ 1.31
Commodity Rate 4,001 to 15,000 gallons	1.285	0.4592	\$ 1.74
Commodity Rate 15,001 gallons and over	1.551	0.4592	\$ 2.01

ARSENIC TREATMENT PLANT AND RELATED DEPRECIATION EXPENSE

Line No.	Description	W.O.	Adjusted Total Per Company	%	Allocate Engr. & Design	Total Project	Staff Adjustments	Adjusted Total Per Staff	Appvd. Repr. Rate	Annual Deprec. Expense	Composite Rate
1											
2	SCW WP1 - Engineering & Design	50028304	\$ 2,339,776								
3	SCW WP2 - Engineering & Design	50064058	739,590								
4			\$ 3,079,366								
7											
8											
9											
10	304 - SCW WP1 Struct. & Improv.	50072958	\$ 4,206,012	59.64%	\$ 1,395,424	\$ 5,601,436	\$ -	\$ 5,601,436	1.67%	\$ 93,544	
11	320 - SCW WP1 Water Trmt. Equip.	50072959	2,735,503	38.79%	907,555	3,643,058	-	3,643,058	4.00%	145,722	
12	339 - SCW WP1 Other Plnt. & Equip.	50072960	9,868	0.14%	3,274	13,142	-	13,142	4.02%	528	
13	345 - SCW WP1 Power Oper. Equip.	50072961	101,044	1.43%	33,523	134,568	(134,568)	(0)	5.02%	(0)	
14			\$ 7,052,428	100%	2,339,776	9,392,204	\$ (134,568)	\$ 9,257,636		239,795	
15											
16	320 - SCW WP2 Water Trmt Equip	50064059	\$ 1,581,364	43.14%	\$ 319,055	\$ 1,900,419	\$ -	\$ 1,900,419	4.00%	\$ 76,017	
17	331 - SCW WP2 Trmsn. & Dist. Mains	50072164	991,812	27.05%	200,067	1,191,679	-	1,191,679	1.53%	18,233	
18	346 - SCW WP2 Comm. Equip.	50072167	100,354	2.74%	20,247	120,601	-	120,601	10.30%	12,422	
20	304 - SCW WP2 Struct. & Improv.	50072182	992,370	27.07%	200,220	1,192,590	-	1,192,590	1.67%	19,916	
21			\$ 3,665,700	100%	739,590	4,405,290	\$ -	\$ 4,405,290		\$ 126,588	
22			\$ 10,718,128		\$ 3,079,366	\$ 13,797,494	\$ (134,568)	\$ 13,662,926		\$ 366,382	2.66%
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Arsenic Plant Rate Base - Per Company \$13,797,494
 Arsenic Plant Rate Base - Per Staff \$13,662,926
 Staff's Adjustment \$ 134,568

Depreciation Expense - Per Company \$ 373,138
 Depreciation Expense - Per Staff \$ 366,382
 Staff's Adjustment \$ 6,756

Line No.		[A] Per Company	[B] Staff Adjustments	[C] Per Staff
1	Arsenic Plant Revenue Requirement			
2	Arsenic Plant in Service/Rate Base	\$ 13,797,494	\$ (134,568)	\$ 13,662,926
3	Depreciation rate	2.70439%	-0.049%	2.66%
4	Depreciation expense	373,138	(10,329)	362,809
5	Depreciation expense net of tax savings ¹	229,112	(6,342)	222,770
6	Recoverable O&M costs	-	-	-
7	Recoverable O&M costs net of tax savings ¹	-	-	-
8	Arsenic Operating Income	\$ (229,112)	\$ 6,342	\$ (222,770)
9	Rate of return	-1.66%	(0)	-1.63%
10	Required Rate of Return ²	6.50%	-	6.50%
11	Required Operating Income	896,837	8,747	888,090
12	Operating Income deficiency	1,125,949	15,089	1,110,860
13	Gross revenue conversion factor ²	1.62863	-	1.62863
14	Revenue deficiency	<u>\$ 1,833,754</u>	<u>\$ 24,575</u>	<u>\$ 1,809,180</u>
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21	³ 38.5986 % tax rate per Dec. 67093			
22	² Decision no. 67093			
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Line No.	[A] Growth	[B] Customers	[C] Total Gallons Sold Per Cust.	[D] Monthly Minimum	[E] Minimum Multiples	[F] Equivalent Meters	[G] Fixed Increment Monthly	[H] Annual Total
1	Jun. 2005 (Year 1)	15,320	1,853,307	5.87	1.0	14,375	3.70	637,576
2	Jun. 2006 (Year 2)	15,349	2,086,523	5.87	1.0	3	3.70	133
3	Year 2 minus Year 1	29	233,216	32.08	2.6	541	9.43	24,003
4	Percentage Change	0.19%	12.58%	47.05	5.5	2,981	20.20	132,231
5	Avg Gallons (Col B Ln 1 + Col B Ln 2 + 2)	1,969,915		81.26	8.0	2,220	29.63	98,450
6				120.82	13.8	206	51.17	9,116
7				165.73	20.6	41	76.08	1,828
8				35.22	28.2	28	104.35	1,253
9				52.84	6.0	-	22.18	-
10				70.45	9.0	-	33.27	-
11					12.0	-	44.36	-
12						20,395		904,590
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Calculation of Surcharge

Total costs to be recovered (Sch. 5 Col A Ln 13)	\$ 1,809,180	Minimum Surcharge	\$ 904,590	Commodity Surcharge	\$ 904,590
Minimum Revenue (Col B Ln 33 + 2)					
Commodity Revenue (Col B Ln 33 + 2)					
Monthly Increment Per Equivalent Meter					
Equivalent Meters (Col F Ln 29 x 12 Months)	244,740				
Minimum Surcharge (Ln 34 + Ln 38)	\$ 3.70				
Average Gallons (Col B Ln 5)	1,969,915				
Commodity Surcharge (Ln 35 + Ln 42)	\$ 0.4592				

MEMORANDUM

DATE: September 27, 2006

TO: Crystal Brown
Public Utilities Analyst V

FROM: D. Hains, P. E. DH
Utilities Engineer

RE: Arizona-American Water Company Sun City West Water District
ACRM Step-One Surcharge Filing
(Docket No. W-01303 A-05-0280; WS-01303 A-02-0867; - W-S-01303
A-02-02869; WS-01303 A-02-0870)

Introduction

Arizona-American Water Company Sun City West Water District ("Sun City West" or "Company") has filed a Step-One Surcharge ACRM application. An inspection and evaluation of the Company's Sun City West arsenic treatment systems was conducted by Dorothy Hains, Water Utilities Engineer, in the accompaniment of Ed Radwanski and Peter Keenan, representatives from the American Water Company parent of Arizona-American Water Company, on August 28, 2006.

Treatment Systems

Based on the arsenic levels and flow capacities of its wells, the Company concluded that two different types of arsenic treatment should be employed to reduce the level of arsenic produced by its wells. The following table lists the arsenic and flow capacities of the wells in the Sun City West systems. As can be seen, the majority of the wells listed contain arsenic levels exceeding 10 µg/l.

Well ID	ADWR Well Registration #	Average Arsenic ¹ (µg/l)	Maximum Arsenic ¹ (µg/l)	Flow in gallons per minute ("gpm")
1.1	55-547409	25.7	34	1,240
1.2	55-610217	21.0	22	1,050
1.3	55-612963	15.2	20	900
1.4 ²	55-205590	27.8 ³	34 ³	1,400 ⁴
1.5	55-610220	25.0	30	900
2.1	55-547408	6.6	10	890
2.2	55-610215	11.6	20	775
2.3	55-610214	8.3	10	970

2.4	55-520840	19.3	25	900
2.5	55-612959	13.7	17	930

- Notes: 1. An average arsenic level for each well was determined based on approximately 10 water quality samples collected between 1995 and 2002.
2. Because the well casing collapsed in 2005 a new well No. 1.4 was drilled to replace the collapsed Well # 1.4 (DWR #55-610219).
3. The arsenic level listed is for the old collapsed well No.1.4 (DWR #55-610219). Initial arsenic test results for the new well No.1.4 show its arsenic level is 26 µg/l.
- #4. The well pump capacity listed is for the new well. The collapsed well pump capacity was 1,000 gpm.

I. Arsenic Treatment Plant #1

Groundwater from Well Nos. 1.1, 1.2, 1.3, 1.4, and 1.5 will be treated by adding an initial pH adjustor, sodium hypochlorite (NaOCl) and ferric chloride (FeCl₃), followed by filtration, blending and a final pH adjustment and disinfection by NaOCl before the treated water is delivered to customers. The wastewater from backwashing the filter will be treated with polymer to thicken the sludge before it is either hauled away to the landfill or discharged to the sewer collection system.

II. Arsenic Treatment Plant #2

Arsenic levels in Well No. 2.1 and 2.3 are below the standards, therefore no treatment was required, water produced by these wells is blended with treated water from Well Nos. 2.4 and 2.5. Groundwater from Well Nos. 2.4 and 2.5 will be treated by NaOCl, followed by adsorption to remove arsenic by Severn Trent Bayoxide E-33 media. The treated water is blended with the untreated water from Well No. 2.1, 2.2 and 2.3 before it is delivered to customers. Wastewater from backwashing the media will be deposited of in an on-site backwash equalization tank, the liquid is then pumped to the sewer collection system.

Final treated water samples from both treatment plants have been tested separately and test results show that arsenic levels in the final treated water are below the new arsenic standard.

Costs

The Company has estimated its total construction cost to be \$13,797,494. Staff found \$120,744 expenses for Well No. 1.4 include in the \$13,797,494. Based on the data from 2005 Annual Report, Staff calculated the system performance and concludes that Well No. 1.4 replacement is a function of source production, not part of arsenic treatment. Therefore, Staff recommends that Well #1.4 be removed from the \$13,797,494. The itemized costs are listed below:

Acct #	Description	Plant #1 Company's Cost (\$)	Plant #2 Company's Cost (\$)	Company's Total Cost (\$)	Staff Adjusted Cost (\$) ¹	Total
	Engineering & Design ²	2,339,776	739,590	3,079,366		
304	Structure & Improvement	5,601,436	1,192,590	6,794,026	(11,911)	6,782,115
320	Water Treatment Equipment	3,643,058	1,900,419	5,543,477	(7,747)	5,535,730
339	Other Plant & Equipment	13,142	0	13,142	(28)	13,114
345	Power Operation Equipment	134,568	0	134,568	(286)	33,509
					(100,773)	
331	Transmission & Distribution Mains	0	1,191,679	1,191,679		1,191,679
346	Communication Equipment	0	120,601	120,601		120,601
	Total			13,797,494	(120,744)	13,676,750

Staff believes that these costs as adjusted by Staff are reasonable and the plant additions appropriate. Staff determined that this plant was in service at the time of its inspection.

Summary

I. Recommendations:

- Staff recommends that \$120,744 which was associated with the Well 1.4 work be removed from the ARCM filing because this plant was not required for arsenic treatment.

II. Conclusions:

- Staff believes that the arsenic treatment plant costs as adjusted by Staff are reasonable and the plant additions appropriate. Staff determined that this plant was in service at the time of its inspection.

¹ The Company stated that \$19,971 and \$100,773 were for Well No. 1.4 replacement work, and the Company agreed that those costs should be removed from ARCM (the total of \$19,971 plus \$100,773 is \$120,744). The Company listed \$19,971 in the expense for Plant #1 Engineering Design cost and \$100,773 was listed in Account #345.

² The Company stated that these expenses had been allocated in all accounts. The Company allocated 59.64% of Engineering & Design ("ED") expense to Account # 304, 38.79% of ED expense to Account # 320, 0.14% of ED expense to Account #339 and 1.43% of ED expense to Account #345.

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 JEFF HATCH-MILLER
 Chairman
3 WILLIAM A. MUNDELL
 Commissioner
4 MIKE GLEASON
 Commissioner
5 KRISTIN K. MAYES
 Commissioner
6 BARRY WONG
 Commissioner

8 IN THE MATTER OF THE APPLICATION	}	DOCKET NOS. W-01303A-05-0280
9 OF ARIZONA-AMERICAN WATER		WS-01303A-02-0867
10 COMPANY, AN ARIZONA		WS-01303A-02-0869
11 CORPORATION, FOR AUTHORITY TO		WS-01303A-02-0870
12 IMPLEMENT AN ARSENIC COST		
13 RECOVERY MECHANISM FOR ITS SUN		
14 CITY WEST WATER DISTRICT		DECISION NO. _____

14 Open Meeting
15 October 17, 2006
16 Phoenix, Arizona

16 BY THE COMMISSION:

17 **INTRODUCTION**

18 Pursuant to Decision No. 68310¹, Arizona-American Water Company, Inc. ("Arizona-
19 American" or "Company") filed an application on August 30, 2006, with the Arizona Corporation
20 Commission ("Commission") requesting authorization to implement Step-One of the Arsenic Cost
21 Recovery Mechanism ("ACRM") for its Sun City West Water District. The average residential
22 customer bill would increase by approximately \$8.41 (or 49.44 percent) from \$17.01 to \$25.42.

23 On January 23, 2001, the United States Environmental Protection Agency reduced the
24 drinking water standard for arsenic from 50 parts per billion ("ppb") to 10 ppb. All community
25 water systems and non-transient non community water systems needed to comply with the new
26 federal rule by the January 23, 2006 deadline.

27 _____
28 ¹ Dated November 14, 2005

1 On November 22 and December 13, 2002, the Company filed applications with the
2 Arizona Corporation Commission ("Commission") for fair value determinations of its utility plant
3 and for permanent rate increases for five of its districts (Sun City West Water and Wastewater,
4 Sun City Water and Wastewater, Havasu and Mohave Water, Agua Fria Water and Wastewater,
5 and Tubac Water). On June 30, 2004, the Commission issued Decision No. 67093 establishing
6 permanent rates for these five districts.

7 On February 15, 2005, the Commission issued Decision No. 67593 granting the
8 Company's request to reopen the record in Decision No. 67093 for the limited purpose of serving
9 as evidentiary basis for future ACRM filings for the affected Arizona-American water districts.

10 By Procedural Order issued March 29, 2005, Arizona-American was directed to file a new
11 application indicating the relief sought regarding the ACRM, and to consolidate the new
12 application with those existing dockets from Decision No. 67093 that would be affected by the
13 specific relief request in its filing.

14 On April 15, 2005, the Company filed an application (Docket No. W-01303A-05-0280) for
15 authority to implement ACRMs for its Agua Fria Water, Sun City West Water, Havasu Water, and
16 Tubac Water Districts.

17 On May 4, 2005, the Company filed a Motion to Delete the Tubac Water District from its
18 application.

19 By Procedural Order issued May 6, 2005, the Company's request to delete the Tubac Water
20 District from its application was approved

21 On November 14, 2005, the Commission issued Decision No. 68310 granting Arizona-
22 American Water Company's application for authority to implement an Arsenic Cost Recovery
23 Mechanism and a Havasu District Arsenic Impact Fee ("AIF") Tariff subject to the terms and
24 conditions contained in that Decision.

25 On April 21, 2006, Arizona-American Water Company, Inc. filed an application with the
26 Commission requesting authorization to implement Step-One of the ACRM for its Agua Fria water
27 district. On June 29, 2006, in Decision No. 68825, the Commission authorized Arizona-
28 American's request to implement Step-One of the ACRM for its Agua Fria Water District.

On October 2, 2006, the Residential Utility Consumer Office ("RUCO") filed its report on its audit of the ACRM to the instant case.

Authorization for an Arsenic Cost Recovery Mechanism (Decision No. 68310)

Decision No. 68310 conditioned approval of an ACRM surcharge on the following criteria:

1. Arizona-American shall comply with all requirements discussed in this Order as a condition of approval of the Arsenic Cost Recovery Mechanism.
2. Arizona-American Water Company shall file a plan with Docket Control as a compliance item in this docket, by December 31, 2005, that describes how the Company expects to attain and maintain a capital structure (equity, long-term debt, and short-term debt) with equity representing between 40 and 60 percent of total capital.
3. Arizona-American Water Company shall file, by April 1st of each year subsequent to any year in which it collects surcharges under an ACRM, a report with Docket Control as a compliance item in this docket showing the Company's ending capital structure by month for the prior year.
4. Arizona-American Water Company shall modify the rate base calculation for the Havasu Water District to explicitly show a deduction for Arsenic Impact Fee collections.
5. That as part of the Earnings Test schedule filed in support of the ACRM, Arizona-American Water Company shall incorporate adjustments conforming to Decision No. 67093.
6. Arizona-American Water Company shall file the schedules discussed in its application, as modified by Staff's recommendations herein. Microsoft Excel or compatible electronic versions of the filings and all work papers should be filed concurrently with all ACRM filings.
7. Arizona-American Water Company shall file permanent rate applications for its Sun City West, Agua Fria, and Havasu districts by no later than April 30, 2008, based on a 2007 test year.
8. For the Havasu District, Arizona-American Water Company shall file with Docket Control as a compliance item in this docket by January 31st of each year, an annual calendar year status report, until the AIF Tariff is no longer in effect. The status report shall contain a list of all customers that have paid the AIF, the amount each customer has paid, the amount of money spent from the AIF, and a list of all facilities that have been installed with funds from the AIF Tariff.

9. Arizona-American Water Company shall file the schedules and information described above, as well as any additional relevant data requested by Staff, as part of any request for an Arsenic Cost Recovery Mechanism step increase.
10. Directed Staff and the Company to open a new proceeding to examine other forms of mitigation of the ACRM for the Havasu system, including the use of hook-up fees for adjacent systems due to the Commission's concern about the impact on the bills of customers served by the Havasu system from the implementation of the ACRM.

Staff Analysis

ACRM Schedules

The Company's Sun City West includes the following schedules.

1. Balance Sheet – dated June 30, 2006.
2. Income Statement – period ending June 30, 2006.
3. Income Statement Adjustments (Earnings Test) – to conform to Decision No. 67093.
4. Rate Review – a rate review filing for the Sun City West Water District.
5. Arsenic Revenue Requirement – an arsenic revenue requirement calculation for Step-One.
6. Surcharge Calculation – a detailed surcharge calculation.
7. Rate Base – a schedule showing the elements and the calculation of the rate base.
8. CWIP Ledger – a ledger showing the construction work in progress account.
9. 4-Factor Allocation for June 30, 2006 – a schedule showing the allocation for all of the Arizona-American Water Company Districts.
10. Typical Bill Analysis – ACRM Step-1 – A typical bill analysis showing the effects on residential customers at various consumption levels including the Average Residential use of 10,020 gallons.

Staff concluded that the filed schedules conform with the methodologies originally required by Decision No. 66400 and that were subsequently adopted by Decision No. 68310. Staff concluded that the Company's Step-One ACRM filing for its Sun City West Water District is complete and in accordance with Decision No. 68310.

1 The ACRM schedules provide for the calculation of a surcharge based on financial records
2 and an Earnings Test Schedule that limit the ACRM surcharge revenue to an amount that would
3 not result in a rate of return exceeding that authorized in Decision No. 67093.

4 Authorization of the Company's requested ACRM in Decision No. 68310 was conditioned
5 on three other items.

- 6 1. Arizona-American Water Company shall file a plan with Docket Control as a
7 compliance item in this docket by December 31, 2005, that describes how the
8 Company expects to attain and maintain a capital structure (equity, long-term debt,
9 and short-term debt) with equity representing between 40 and 60 percent of total
10 capital. The Company docketed an equity plan on November 30, 2005.
- 11 2. For the Havasu District, Arizona-American Water Company shall file with Docket
12 Control as a compliance item in this docket by January 31st of each year, an annual
13 calendar year status report, until the AIF Tariff is no longer in effect. The status
14 report shall contain a list of all customers that have paid the AIF, the amount each
15 customer has paid, the amount of money spent from the AIF, and a list of all facilities
16 that have been installed with funds from the AIF Tariff. The Company docketed an
17 AIF compliance report on February 2, 2006.
- 18 3. The Commission is concerned about the impact on the bills of customers served by
19 the Havasu system from the implementation of the ACRM. Consequently, we direct
20 Staff and the Company to open a new proceeding to examine other forms of
21 mitigation of the ACRM for the Havasu system, including the use of hook-up fees for
22 adjacent systems due to the Commission's concern about the impact on the bills of
23 customers served by the Havasu system from the implementation of the ACRM.
24 Compliance with this condition is met by Docket No. W-01303A-05-0890.²

25 Staff Adjustments to Company's Schedules Adjustments

26 Staff reviewed the Company's invoices and found that some invoices should be removed
27 because they were not incurred for arsenic treatment plant. Staff removed the plant and related
28 allocation of labor costs. The adjustment reduced Arsenic Treatment Plant by \$134,568 from
\$13,797,494 to \$13,662,926.

The adjustment to Arsenic Treatment Plant also reduced depreciation expense by \$6,756
from \$373,138 to \$366,382. Staff's depreciation adjustment was calculated based on the
Commission authorized depreciation rates by account.

...

² A hearing was held on May 8, 2006, and the matter is under consideration by the Hearing Division.

1 The adjustments to plant and depreciation expense reduced the Step-One ACRM surcharge
2 revenue requirement by \$24,575 from \$1,833,754 to \$1,809,180.

3 The Staff recommended Step-One ACRM surcharge rates would reduce the Company
4 proposed monthly minimum surcharge per equivalent billing unit (5/8-inch meter) from \$3.75 to
5 \$3.70 and the commodity surcharge rate from \$0.4654 to \$0.4592 per 1,000 gallons.

6 The Staff recommended Step-One ACRM surcharge rates would increase the average
7 monthly residential customer bill by \$8.30 (or 48.79 percent) from \$17.01 to \$25.31.

8 Staff concluded that the Company's Step-One ACRM filing for its Sun City West Water
9 District, as adjusted, is complete and in accordance with Decision No. 68310.

10 Staff recommended that the Company file with the Commission an arsenic removal
11 surcharge tariff consistent with ACRM Schedule CSB-4.

12 Staff recommended that Arizona-American Sun City West Water District notify its
13 customers of the arsenic cost recovery surcharge tariff approved herein within 30 days of the
14 effective date of this Decision.

15 Staff recommended that in the event that Arizona-American fails to file a permanent rate
16 application for its Sun City West Water system by April 30, 2008, based on a 2007 test year as
17 required by Decision No 66310, the Arsenic Cost Recovery Mechanism surcharge then in place
18 shall be automatically discontinued.

19
20 **RUCO's Analysis and Adjustments to Company's Schedules**

21 RUCO removed costs related to refurbishing a well that it determined was not related to
22 arsenic treatment plant. RUCO's report states that "The Company agrees that the Task order,
23 related AFUDC, and overhead in the amount of \$101,044 should be removed from the ACRM
24 filing." The adjustment reduced Arsenic Treatment Plant by \$101,044 from \$13,797,494 to
25 \$13,696,450.

26 The adjustment to Arsenic Treatment Plant also reduced depreciation expense by \$3,334
27 from \$373,138 to \$369,804.

28 ...

1 The adjustments to plant and depreciation expense reduced the Step-One ACRM surcharge
2 revenue requirement by \$14,030 from \$1,833,754 to \$1,819,724. RUCO's depreciation
3 adjustment was calculated using a composite depreciation rate of 2.70 percent.

4 RUCO recommends a \$3.72 surcharge for the monthly minimum and a \$0.4620 per 1,000
5 gallons on the commodity rate.

6
7 **Discussion of Well Costs**

8 Staff and RUCO both removed costs related to the well. Staff determined that the well cost
9 is related to the Company's source of water production and not part of the arsenic treatment
10 facility. A Company provided work paper indicated that the total cost of the project was \$134,568
11 (i.e., \$101,044 in plant and \$33,523 in allocated labor costs). Staff removed the total cost of the
12 project stated by the Company, and RUCO removed the plant cost absent the related allocation of
13 labor. Therefore, Staff recommends adoption of its adjustment because it reflects removal of all
14 the non-arsenic related costs.

15 We concur with Staff that the appropriate amount to be removed for the well is \$134,568.
16 This amount reflects the total cost of the well as calculated and reported by the Company.

17 Staff and RUCO removed depreciation expense related to the disallowed well of \$6,756
18 and \$3,334, respectively. Staff recommended its depreciation expense over RUCO's because it
19 recognized the Commission authorized depreciation rates by account and Staff's recommended
20 arsenic treatment plant balances.

21 We concur with Staff's depreciation expense calculation.

22 * * * * *

23 Having considered the entire record herein and being fully advised in the premises, the
24 Commission finds, concludes, and orders that:

25 FINDINGS OF FACT

26 1. Pursuant to Decision No. 68310, the Company seeks an arsenic cost recovery
27 mechanism surcharge tariff in this proceeding authorizing a monthly surcharge per customer to aid

28 ...

1 the Company in its efforts to comply with the EPA's new drinking water standard for arsenic from
2 50 ppb to 10 ppb which went into effect on January 23, 2006.

3 2. Pursuant to Decision No. 68310, the Company filed the required schedules prior to
4 the implementation of the ACRM.

5 3. Staff's adjustments to the application are reasonable and appropriate and should be
6 adopted.

7 4. Arizona-American shall file a permanent rate application for its Sun City West,
8 Agua Fria, and Havasu Water Districts by no later than May 31, 2008, based on a 2007 test year.

9 CONCLUSIONS OF LAW

10 1. The Company is a public water service corporation within the meaning of Article
11 XV of the Arizona Constitution and A.R.S. §§40-250 and 40-252.

12 2. The Commission has jurisdiction over the Company and of the subject matter of the
13 application.

14 3. Approval of an arsenic cost recovery mechanism is consistent with the
15 Commission's authority under the Arizona Constitution, Arizona ratemaking statutes, and
16 applicable case law.

17 4. It is in the public interest to approve the Company's request for implementation of
18 the ACRM.

19 ORDER

20 IT IS THEREFORE ORDERED that the application by Arizona-American Sun City Water
21 District is approved as discussed herein.

22 IT IS FURTHER ORDERED that the application by Arizona-American Sun City Water
23 District for approval of an arsenic cost recovery mechanism surcharge tariff shall be in accordance
24 with the attached ACRM Schedule CSB-4.

25 IT IS FURTHER ORDERED that Arizona-American shall notify it customers of the
26 arsenic cost recovery surcharge tariff approved herein within 30 days of the effective date of this
27 Decision.

28 ...

1 IT IS FURTHER ORDERED that the Company shall file with Docket Control, as a
2 compliance item in this docket, a report showing the Company's ending capital structure by month
3 for the prior year. The first report shall be due on April 1, 2007, and shall be provided each
4 April 1st thereafter until such time as a subsequent order of the Commission discontinues the
5 ACRM surcharge.

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28 ...

IT IS FURTHER ORDERED that in the event that Arizona-American fails to file a new rate case application for its Sun City West Water District by May 31, 2008, based on a 2007 test year, the Arsenic Cost Recovery Mechanism surcharge then in place shall be automatically discontinued.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____, 2006.

BRIAN C. McNEIL
Executive Director

DISSENT: _____

DISSENT: _____

EGJ:CSB:lh\DR

1 SERVICE LIST FOR: Arizona-American Water Company
2 DOCKET NOS. W-01303A-05-0280, et al.

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4 Arizona-American Water Company
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8 Mr. Ernest G. Johnson
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28

Arizona-American Water Company
 Sun City West District
 Docket No. W-01303A-05-0280

Schedule CSB-4

RATE DESIGN

Monthly Customer Charge

5/8" Meter

Company Present Rates Without Surcharge	Company Proposed Surcharge	Staff Recommended Surcharge
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\$ 5.87	\$ 3.75	\$ 3.70
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Commodity

Commodity Rate 0 to 4,000 gallons

0.850 0.4654 0.4592

Commodity Rate 4,001 to 15,000 gallons

1.285 0.4654 0.4592

Commodity Rate 15,001 gallons and over

1.551 0.4654 0.4592

Average Customer Water Usage (gallons)

10,023 10,023 10,023

Typical Residential Bill

Under Present Rates Without Surcharge

\$ 17.01

Under Present Rates With Company Proposed Surcharge

\$ 25.42

Under Present Rates With Staff Recommended Surcharge

\$ 25.31

CURRENT RATES INCLUDING SURCHARGE - Per Company**Monthly Customer Charge**

5/8" Meter

Company Present Rates Without Surcharge	Company Proposed Surcharge	Company Total
---	----------------------------------	------------------

\$ 5.87	\$ 3.75	\$ 9.62
---------	---------	---------

Commodity

Commodity Rate 0 to 4,000 gallons

0.850 0.4654 \$ 1.32

Commodity Rate 4,001 to 15,000 gallons

1.285 0.4654 \$ 1.75

Commodity Rate 15,001 gallons and over

1.551 0.4654 \$ 2.02

CURRENT RATES INCLUDING SURCHARGE - Per Staff**Monthly Customer Charge**

5/8" Meter

Company Present Rates Without Surcharge	Staff Recommended Surcharge	Staff Total
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\$ 5.87	\$ 3.70	\$ 9.57
---------	---------	---------

Commodity

Commodity Rate 0 to 4,000 gallons

0.850 0.4592 \$ 1.31

Commodity Rate 4,001 to 15,000 gallons

1.285 0.4592 \$ 1.74

Commodity Rate 15,001 gallons and over

1.551 0.4592 \$ 2.01